

## Message Text

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E.O. 11652: XGDS-1

TAGS: EFIN, GW, OP

SUBJECT: ASSESSMENT OF PORTUGUESE ECONOMIC SITUATION

PASS KINNELLY FOR ROBERT J. RYAN, JR.

1. OUR STUDY FOR THE NSC IS BEING TYPED TODAY IN FINAL.  
ALL OTHER INTERESTED AGENCIES HAVE CLEARED OFF IN DRAFT,  
BUT THE STUDY HS NOT YET REPEAT NOT YET BEEN CLEARED WITHIN  
THE DEPARTMENT AT THE POLICY LEVEL.

2. FOR YOUR BACKGROUND INFORMATION THE EXECUTIVE SUMMARY  
TENTATIVELY READS AS FOLLOWS: QUOTE: A. PORTUGAL'S DRAMATIC  
POLITICAL TURNAROUND SINCE LAST SUMMER IS THREATENED BY  
ADVERSE ECONOMIC CONDITIONS, INCLUDING UNEMPLOYMENT, INFLA-  
TION AND SHORTAGE OF LIQUID FOREIGN EXCHANGE RESERVES. IF  
ECONOMIC CIRCUMSTANCES DO NOT OFFER THE PROSPECT OF IMPROVE-  
MENT BY THE APRIL ELECTIONS, THE PRESENT MODERATE GOVERN-

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MENT WILL UNDOUBTEDLY SUFFER. U.S. INTERESTS IN THE SITUA-

TION INCLUDE OUR CONTINUED ACCESS TO THE AZORES BASES, NATO INTEGRITY, IBERIAN POLITICAL STABILITY AND MAINTENANCE OF AN OPEN ECONOMY AND SOCIETY IN PORTUGAL.

B. IT IS ANTICIPATED THAT THE PORTUGUESE WILL HAVE TO DE-VALUE THE ESCUDO EARLY IN 1976, CONTINUE GOLD SALES OVER

THE COURSE OF THE YEAR, TAKE NECESSARY MEASURES TO CURB WAGES AND REVIVE PRODUCTION, AND BORROW FURTHER SUBSTANTIAL AMOUNTS ABROAD. OUR ANALYSIS OF THE PORTUGUESE BALANCE OF PAYMENTS INDICATES THAT UNDER FAVORABLE CONDITIONS THEY MAY BE ABLE TO SQUEAK THROUGH THE FIRST HALF OF 1976 WITHOUT ACCESS TO MORE THAN THE EXISTING SOURCES OF EXTERNAL BORROWING SUPPLEMENTED BY GOLD SALES AND STEPPED UP AID DISBURSEMENTS, PROVIDED THE BANK FOR INTERNATIONAL SETTLEMENTS ROLLS OVER A \$250 MILLION LOAN AND THE FEDERAL REPUBLIC OF GERMANY EXTENDS A NEW LOAN FOR THE SAME AMOUNT. BUT GIVEN THE POLITICAL/ECONOMIC UNCERTAINTIES, FINANCING NEEDS MAY BE CONSIDERABLY GREATER AND WE SHOULD BE PREPARED TO FACE THIS CONTINGENCY.

C. AS A MINIMUM, DURING THE NEAR-TERM, THE UNITED STATES SHOULD SUPPORT PORTUGUESE LOANS FROM THE INTERNATIONAL MONETARY FUND, ENCOURAGE BILATERAL CREDIT ARRANGEMENTS BETWEEN THE PORTUGUESE AND THE FEDERAL REPUBLIC OF GERMANY AND WHERE FEASIBLE FACILITATE THE ROLLOVER OF THE EXISTING LOAN BY THE BANK FOR INTERNATIONAL SETTLEMENTS. WE SHOULD TRY TO MAKE QUICK DISBURSEMENTS WHERE POSSIBLE IN OUR BILATERAL A.I.D. PROGRAMS AND ENCOURAGE OTHERS TO DO LIKEWISE. PROVIDING THE PORTUGUESE AGREE, WE SHOULD ENCOURAGE THE ESTABLISHMENT OF A MULTILATERAL MECHANISM DESIGNED TO REVIEW THE PORTUGUESE ECONOMIC SITUATION (INCLUDING POSSIBLE ALTERNATIVE SOLUTIONS) AND TO PROMOTE COORDINATION BETWEEN FOREIGN DONORS. EITHER THE OECD OR THE IBRD WOULD SEEM TO BE THE MOST APPROPRIATE ORGANIZATION TO PLAY A LEADERSHIP ROLE, ALTHOUGH IN THE EARLY STATES IT WOULD SEEM DESIRABLE FOR THE PORTUGUESE TO TAKE THE LEAD AND ORGANIZE THE FIRST MEETING.

D. IN ANTICIPATION THAT THE BALANCE OF PAYMENTS SITUATION  
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TION MAY DETERIORATE MORE SUBSTANTIALLY, THE UNITED STATES SHOULD BE PREPARED TO CONSIDER FURTHER MEASURES. THE QUICKEST-ACTING MEANS OF HELP IN FIRST-HALF 1976 WOULD SEEM TO BE THROUGH CREDITS BY THE COMMODITY CREDIT CORPORATION. A SPECIAL AID APPROPRIATION OR AN INCREASED PL-480 PROGRAM WOULD BE DESIRABLE IF PORTUGAL CANNOT MEET ITS SHORT-TERM NEEDS FROM OTHER SOURCES, BUT EITHER WOULD ENCOUNTER SERIOUS BUDGETARY AND LEGISLATIVE OBSTACLES.

ADDITIONAL EXIMBANK CREDITS AND PL-480 WOULD HELP AT LEAST IN SECOND-HALF 1976. HOWEVER, THE ANALYSIS CONTAINED IN THIS PAPER SHOWS THAT PORTUGAL'S OVERALL BALANCE OF PAYMENTS DEFICIT COULD RANGE ANYWHERE BETWEEN \$1.0 AND \$1.8 BILLION IN 1976. THUS, WHILE ADDITIONAL U.S. ASSISTANCE WILL BE HELPFUL IN A POLITICAL SENSE, THE AMOUNTS WHICH IT WILL BE POSSIBLE TO UNDERTAKE IN THE NEAR FUTURE WILL NOT BE LARGE ENOUGH ALONE TO OFFSET A MAJOR

DETERIORATION IN THE PORTUGUESE BALANCE OF PAYMENTS POSITION.

E. OVER THE LONGER TERM, WE CAN EXPECT THAT PORTUGAL IS LIKELY TO FACE CONTINUED FINANCING NEEDS FOR SOME YEARS TO COME, ALTHOUGH ON A DECLINING BASIS. MULTILATERAL ASSISTANCE THROUGH THE WORLD BANK, THE EUROPEAN INVESTMENT BANK AND THE EFTA INDUSTRIALIZATION FUND WILL BE IMPORTANT, IN ADDITION TO BILATERAL ASSISTANCE PROGRAMS SUCH AS OUR OWN. END QUOTE

3. TABLE 2 REVISED TO INCLUDE \$88 MILLION OIL FACILITY DRAWING IN 1976 FINANCING SOURCES. PL-480 DISBURSEMENTS IN FIRST HALF 1976 ALSO INCREASED FROM \$10 TO \$15 MILLION. RESULT IS THAT WITH ALL THE STATED CAVEATS PORTUGAL COULD SQUEAK THROUGH FIRST-HALF 1976, UNDER OPTIMISTIC CONDITIONS (CASE A), BY BORROWING ABOUT \$400 MILLION (INCLUDING FROM OIL FACILITY) AND STILL HAVE SOME MARGIN FOR ERROR COVERED BY THE POSSIBILITY OF DRAWING ON THE COMPENSATORY FINANCING FACILITY. WITHOUT THE SAME MARGIN, IT COULD SQUEAK THROUGH THE FIRST HALF UNDER PESSIMISTIC CONDITIONS (CASE B) BY BORROWING \$500 MILLION (INCLUDING FROM OIL FACILITY). SECOND-HALF 1976 REMAINS ROUGHLY THE SAME (WITH DEFICIT COVERED UNDER OPTIMISTIC SECRET

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CONDITIONS BUT FAR FROM COVERED UNDER PESSIMISTIC CONDITIONS), EXCEPT THAT UNDER OPTIMISTIC CONDITIONS THERE IS AGAIN A LITTLE MORE MARGIN BY VIRTUE OF NOT HAVING HAD TO DRAW THE SECOND CREDIT TRANCHE IN THE FIRST HALF. THE ANALYSIS DOES NOT TAKE INTO ACCOUNT POSSIBLE ADDITIONAL BIS CREDITS REPORTED IN LISBON 406.

4. CONCERNING A CONSORTIUM-TYPE ARRANGEMENT, TEXT LEAVES OPEN POSSIBILITY (AS INDICATED IN EXECUTIVE SUMMARY) THAT IT COULD BE EITHER THROUGH THE OECD OR THE IBRD AND, IN ANY EVENT, IT MIGHT BE PREFERABLE FOR PORTUGUESE TO TAKE THE LEAD AND ORGANIZE THE FIRST MEETING. (COMMENT: THIS IS SOMETHING WHICH OBVIOUSLY NEEDS TO BE EXPLORED WITH THE PORTUGUESE AND THE OTHER COUNTRIES GIVING MAJOR ASSISTANCE IN ORDER TO LAND ON THE RIGHT OPTION.) SISCO

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